CT/17/43
Devon Pension Board
10th April 2017

COST TRANSPARENCY

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Board before taking effect.

Recommendation: that the Board note the results of the Actuarial Valuation.

1. Introduction

1.1 In recent years there has been an increasing focus on investment costs in the LGPS. Making savings on investment costs has been one of the key drivers of the Government's pooling agenda. There has also been increasing scrutiny by the media and various policy think tanks.

1.2 It could be argued that the key issue for Pension Funds is net performance and costs are less important. An additional 0.5% in management fees is worth paying if it provides a 5% higher return. However improved transparency in reporting costs can only help in monitoring performance, and there has been a gradual increase in the transparency required by accounting guidance.

1.3 This report sets out the impact of revised guidance to date and potential future requirement.

2. Devon Investment Management Costs

2.1. An analysis of the investment management expenses included in the Devon Pension Fund's statement of accounts over the last three years shows the following costs:

- 2013/14 £7,558,000
- 2014/15 £10,562,000
- 2015/16 £11,840,000

These costs include external fund manager fees, custody fees, transaction costs, broker commissions, and Devon County Council investment management costs. The fund manager fees represent over 80% of the investment management expenses.

2.2. From these figures it would appear that there was a significant increase in cost between 2013/14 and 2014/15. However this does not reflect a real increase in the costs incurred, but an increase in the extent of the costs disclosed. The Devon Fund invests in a number of pooled funds where the management is taken directly from the fund and netted off against the value of the fund rather than being invoiced. In 2013/14 and before the practice was to only include external manager fees that were invoiced to the fund. However in 2014/15 the guidance changed and the value of the fees charged by the pooled funds was grossed up against performance gains and then shown as a cost. This resulted in fees to the value of £2.678m being included which previously would not have been.

2.3. The inclusion of the pooled fund fees accounts for most of the change in 2014/15. Other things being equal the management fees should increase or decrease roughly in proportion to the size of the fund, as in general they are charged as a % of the value of the assets being managed, and a 10% investment return in 2014/15 will also have contributed.

2.4. There was a small increase in costs in 2015/16, but this largely reflected a one-off trading cost that was over-stated, without which there would have been a small reduction in the investment management expenses reported.

3. 2015/16 Disclosure Guidance

3.1. While the increased in management expenses between 2013/14 and 2014/15 represented an increase in transparency around investment costs, there is still further to go to provide complete transparency. In the opinion of officers, the CIPFA guidance issued in November 2015, which was relevant to production of the 2015/16 accounts, contained a number of grey areas which may have been interpreted differently by different LGPS funds.

3.2. An example of this is the guidance on fund of fund type arrangements. The Devon Fund uses Aviva to manage its property portfolio and Aviva invests in pooled property funds which will have management fees taken directly from the funds. In addition, the Devon Fund has investments in two diversified growth funds, which will both invest in other funds which will incur fees. The 2015 guidance states that:

> *As costs will be incurred at each tier in the investment structure, to avoid under-reporting, costs should reported gross up to the level where the pension fund has both:*
>
> - *contractual liability to pay; or*
> - *control or significant influence over the investment decisions that are being made.*

In discussion with other LGPS funds with similar investments, it was concluded that the Devon Fund did not have control or significant influence over the investments made by Aviva or the diversified growth funds and therefore these costs were not disclosed in the statement of accounts for 2015/16.

3.3. Another potential area for disclosure would be bid/offer spread costs. Generally the price at which shares can be bought on the market is higher than the price at which they can be sold, and this difference is known as the bid/offer spread and could be seen as a cost. The 2015 guidance states:

> *This guidance does not require that these costs be quantified and disclosed but the notes to the financial statements should explain their existence.*

3.4. There are therefore a variety of other costs that are difficult to identify, and therefore further disclosures that could be made.

4. 2017 Transparency Code

4.1 To assist LGPS funds in obtaining the data they require in order to report costs on a transparent basis, the LGPS Scheme Advisory Board has been developing a voluntary Code of Transparency for LGPS asset managers.

4.2 Those asset managers who sign up to the 'Code of Transparency' will be listed on the LGPS Scheme Advisory Board website and will be able to use the Code logo on their marketing literature. The Code will be voluntary with asset managers encouraged to sign up to it to demonstrate their commitment to transparent reporting of costs.

4.3 Asset managers will supply the information on a template in the format requested and in a timely manner and will agree to the data being checked by a third party to ensure they are continuing to comply with the requirements of the Code.

4.4 The template will be developed over time to encompass other more challenging areas of cost transparency and will remain flexible to enable changes to meet the rapidly developing market for investment products.

4.5 We are still awaiting publication of the new transparency code and the final version of the template to be provided to asset managers. Therefore it is currently unclear what impact this will have on the 2016/17 statement of accounts.

5. Conclusion

5.1 The move toward investment fee transparency and consistency is seen as an important factor in the LGPS being perceived as a value led and innovative scheme. Transparency is also a target for the revised CIPFA accounting standard issued for inclusion in the statutory annual report and accounts and included in the government's criteria for pooling investments.

5.2 There has been significant progress made on this agenda in recent years, but the new 2017 transparency code should take this to a new level once it is finalised. As a result it is likely that there will be further increases in future years in the investment management expenses included in the Fund's Annual Report and Statement of Accounts, but this is to be welcomed as an increase in transparency, rather than a result of a real increase in the cost of managing investments. The key factor in assessing the performance and effectiveness of the Fund will be the investment return net of investment costs, rather than focusing purely on the costs themselves.

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Electoral Divisions: All
Local Government Act 1972
List of Background Papers - Nil
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